

Chinese yuan and economic balance

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Introduction In the increasingly globalized business environment, the foreign exchange market is playing a more and more important role. This essay firstly discusses the valuation of Chinese Yuan and the global economic balance with reference to the case " Chinese Yuan and Economic Balance" (Question 1). Secondly, it continues to focus on the situation of Japanese Yen, based on the article " The Yen and Exports: Japan's Continued Recovery" (Question 2). Finally, it discusses three questions about foreign exchange calculations. Question 3) Question 1 a) According to the article " Chinese Yuan and Economic Balance", Chinese Yuan has been undervalued for years. The implications of such undervaluation are two-sided. To China, an undervalued Yuan largely benefits its exportation of goods and services. This is because when Yuan is cheaper, Chinese goods are cheaper, inducing foreign parties to import from the Chinese market. However, such a situation may not be beneficial for the whole global market. Imbalances in the world economy have occurred.

A number of critics claimed that the undervalued Yuan is an unfair subsidy to the Chinese exportation. China starts suffering from appreciation pressures from the outside, and the pressure is even stronger under the tough economic conditions today. To sterilize the Yuan from such appreciation pressures, China has pursued several policies. Historically, Chinese Yuan was pegged to the US dollar at 1.5 Yuan to the dollar. After the " opening" in 1984, the pegging rate was adjusted to 8.62 in order to improve the competitiveness of Chinese exports.

Recently, under the pressure, the central bank lifted the peg to 8.11 Yuan to the dollar. In 2010, China switched the policy to a " managed unpinning"

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mechanism, under which Yuan is valued more rely against a basket of currencies. This mechanism will have various influences on China and the US. For China, there are both merits and defects. Although this policy tends to make exports less profitable, create massive unemployment and make displaced workers harder to find jobs, it also can cut the importation costs for China, liberate China's interest-rate policy and give consumers more spending power.

Therefore, the consequences of a stronger Yuan are two-sided. There exist both challenges and opportunities. Chinese Yuan and Economic Balance By Hunter appreciation of Yuan depends on a basket of currencies, including the US dollar, the Euro, the Japanese yen, the Korean won and some other currencies, the relative exchange rate between Chinese Yuan and the US dollar does not have an obvious trend in the short-term. In addition, the basis of a basket of currencies itself can make the appreciation pace steady. Therefore, there may not be obvious influences for the US in the short term.) In good times, an undervalued Yuan does not matter much to the US and Europe, because the unemployment rates were low and outsourcing was not considered problematic. However, in tough times, trade imbalances were created, causing worse unemployment. Problems are rising from large amount of exportation. As a result, some critics view this issue as problematic, stating that it may worsen the global crisis. Despite that some groups in the US and Europe suffer from an undervalued Yuan, some other parties do benefit from such exchange rates. For example, large manufacturing companies can outsource resources and labor at lower prices.

Their costs to purchase raw materials and pay for Chinese labor are comparably cheaper. Multinational companies are another example. They can build headquarters or subsidiary offices in China with lower investment costs, because the prices for lands, equipment, utilities and even some administrative costs are cheaper. Therefore, these companies can lower their input costs and enjoy higher profits. C) We think that Yuan will appreciate in the future. The reasons are as follows: Firstly, Yuan will ultimately appreciate under the pressure from the market.

China needs to cope with the high inflation with the exports rebound and domestic focus. As the appreciation of the exchange rate can be used to control inflation, there will be pressure on China to appreciate its currency versus the US dollar. Also, the US dollar has been losing its value rapidly so china may try to appreciate Yuan to show the flexibility in the context of the international pressure. Secondly, the appreciation of Yuan should take place gradually and it will be good for the balance of global currency and the stabilization of the global economy.

It is because rapid appreciation may promote more speculative inflows which is not welcome in the market. Also, it eases the trade tension between the United States and China. This was essential as the world's largest economies need to work cohesively in a feeble global economic environment. From China's perspective, gradual Yuan appreciation would be positive for the economy. Industrial significant growth is still impending in the country, the pattern of imports is expected to remain the same. A stronger Yuan would increase the purchasing power of commodity importers.) Strong yen would reduce the foreign demand for the Japanese goods. Japanese products

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become relatively expensive to foreign importers due to the high exchange rates. That deters the overseas customers from purchasing the products or sending back the sales. In the long run, that would attribute to profit drop. Besides, comparatively the exchange rates in other countries are low. The products exported from these countries would be cheaper and more attractive to the overseas sales. The profit gain would be maximized by the increase in quantity of sales.

Also, greater emergence in foreign market induces the expansion of scale for facilitating the development of the company. Sony has its revenue growth from the emerging market for about 40% and the sales in Brazil almost doubled during the second quarter of 2010. Similarly, merger and acquisition is cheaper for the high value of yen to other currencies. According to TOKYO Marketplace, 455 cases of merger and acquisition, which has been the largest numbers since 1996, was recorded in 2011 with the monetary value of ¥6. Trillion under the effect of strong yen. Also in view of this, the Japanese government established a credit line worth \$43 billion between the Japan Bank for International Cooperation and the three biggest Japanese commercial banks. Demand reflected the charm of merger and acquisition during the appreciation.) Before, Japan was experiencing the economic downturn during which yen was not that valued. Importing Japanese goods was of great profitable potential. Therefore, the export during that period increased significantly.

The economic has been recovered and the value of yen becomes higher. However, yen continues to appreciate and the prices of the domestic products become so high that threaten the sales demand. The companies

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therefore have the concern that the increase in export was due to the relative strength of yen to other currencies and may be short lived. Actually, their once is correct. The yen's strength has eroded profits at Japanese exporters such as Sharp Corp.. And Honda Motor Co. As faltering global growth undermines demand. The yen averaged 77. 3 per dollar in the quarter ended December compared with 82. 50 a year earlier. (Bloomberg, 2012) However, they can barely rely on the government to dampen the currencies by selling the currencies for it would be hard and of temporary effect Also, the bank of Japan could not probably count on coordinated action from the European Central Bank and the United States Federal Reserve which have no interest n strengthening their currencies to combat the strong yen. Therefore they could resort to protect themselves by preparing for the risk with the hedging strategies.

As London, New York and Japan are the three most dominant countries in global foreign exchange market(London with 34% share, New York City with 16. 6% and Tokyo with 8% in 2008), the fluctuation of dollar or Euro would be most sensitive for caution of risk. So the hedging strategies based on the expectations on the relative value of the yen in relation to these two currencies would be more effective and appropriate Han other currencies. C) Other than the traditional hedging, the companies can strategically and operationally adapt to the foreign market for mitigating the risk of the strong yen. Acquisition. On the other hands, they could downscale some of the back production which would be redundant to minimize the cost. For example, to cope with the market trend, Lipid, a Japanese Electronic company, has reviewed its business plans and decided to cut production and postpone the

second phase of Recipe's facility expansion. In tandem with these cutbacks, Lipid intends to accelerate downscaling ND sharpen its focus on mobile DRAMs(Semiconductor, 2010). Also, exchanging yen- denominated assets into foreign currency would reduce the impact from the rising yen directly.

For the operational adaptation, the companies can develop offshore capabilities for reducing the cost of production. Panasonic has used foreign engineers to develop the products. It innovates and improves the products that cater most to the local's need. Panasonic altered the configuration of its refrigerators for Indonesian need more space to accommodate large two-liter bottles of water. It is also developing energy- onscreen and quiet air conditioners because Indians tend to run the air conditioner for whole day, which generates great burden on the grid and noise.

These actions reversed the loss of 52 billion to a profit of 84 billion. Its revenue from the emerging markets was expected to increase from present 25% to 31% in 2012. These hedging strategies are consistent with some of the large issues implicit inglobalization. For instance, average trading volume on the Tokyo Stock Exchange, which runs the world's second-largest equity market, fell 8. 2 percent to 2. 12 billion shares a day in 2010 as the demand was very weak. Tokyo Stock Exchange Group Inc. Hence had merger discussions with Osaka Securities Exchange Co. s takeovers sweep exchanges around the world for garnering the higher valuation derivatives component of exchanges globally(Bloomberg, 2011). The Japanese companies are actually globalization in the course of combating strong yen.

Question 3 a) It is important that international businesses understand the influence of exchange rates on the profitability of trade and investment

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deals. Adverse changes in exchange rates can make apparently profitable deals unprofitable. The risk introduced into international business transactions by changing exchange rate is referred to as foreign exchange risk.

This risk is usually divided into the three important types of exposure to currency exchange rate fluctuations which are transaction exposure, translation exposure and economic exposure. Is affected by fluctuations in foreign exchange values. This exposure includes the obligations for the purchase or sale of goods and services at previously agreed prices and the borrowing and lending of funds in foreign currencies. This can lead too real monetary loss as well. Translation exposure is the impact of currency exchange rate changes on the ported financial statements of a company. It is concerned with the present measurement of past events. Gains and losses from translation exposure are reflected only on paper. The resulting accounting gains or losses are said to be realized are still important.

Economic exposure is the extent to which a firm's future international earning power is affected by changes in exchange rates. It concerned with the long-term effect of changes in exchange rates on future prices, sales, and costs. This is distinct from transaction exposure, which is concerned with the effect of exchange rate hanged on individual transactions, most of which are short-term affairs that will be executed with a few weeks or mouths.)

Suppose the unit price for pogo sticks is in North Pogo and \$8 in South Pogo, while the current exchange rate is \$1 = Explain how the current exchange rate between and \$ will get adjusted by market forces through the Law of One Price. What will be the adjusted exchange rate between the two

currencies? In competitive markets where transportation costs are assumed to be negligible and there are no trade barriers, the Law of One Price states that: Identical products sold in different countries must sell for the same price when their price is expressed in terms of the same currency.

If exchange rates are flexible in the market, then we will expect exchange rates to adjust in order to equalize prices. The current exchange rate is \$1 = ¥4. Therefore, when a pogo stick is sold for ¥40 in North Pogo, it should also be sold for \$10 in South Pogo because the exchange rate is \$1 = ¥4. However, the pogo stick is sold for \$8 in South Pogo and ¥40 in North Pogo now. People will convert to get \$8 in order to buy a pogo stick in South Pogo and sell it in North Pogo for ¥40. They can gain a profit of ¥32 per pogo stick. Due to this market force, there will be an increased demand for ¥. It will raise the value of ¥.

On the other hand, increased supply for ¥ would lower its price. This exchange rate movement will continue until prices are equalized. Therefore, the exchange rate will change from \$1 = ¥4 to \$1 = ¥32. The interest rate in South Pogo (is) by 4%. What would the Fisher effect imply about the expected difference in inflation rates between North Pogo and South Pogo, where we denote the expected inflation rates in North and South Pogo as I_N and I_S respectively. What would you expect to be the effect on the exchange rate between North Pogo and South Pogo? Interest rates affect expectations about future exchange rates.

Fisher Effect states that: nominal interest rate (I) is the sum of real interest rate (r) and expected rate of inflation (I): $I = r + I$. In the long-run, real interest rates in different countries get equalized over time. So, if the real interest rate is the same everywhere, any difference in interest rates

between countries reflects differing expectations about inflation rates. Since real interest rate must be the same in all countries, the different is the inflation rate.